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SENATE COMMITTEE ON BANKING, HOUSING AND URBAN DEVELOPMENT

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TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
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Chairman Johnson, Ranking Member Shelby, and members of the Committee, I am honored to appear before you today to discuss the Department of the Treasury's Troubled Asset Relief Program ("TARP").

This past quarter, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") marked its second anniversary. I want to thank Congress and members of this committee for the tremendous support that SIGTARP has received in its brief existence. As a direct result of that support, in the time since its inception in December 2008, SIGTARP has had notable success in fulfilling its goals of transparency, oversight, and enforcement. To date, through nine quarterly reports and 13 completed audits, SIGTARP has brought light to some of the darkest areas of the financial crisis and the Government's response to it, and has offered Treasury 68 recommendations to help program effectiveness and protect the taxpayer from losses due to fraud. Where fraud has managed to slip in, we have acted as TARP's "cop on the beat," and SIGTARP's Investigations Division has already produced outstanding results. To date, 51 individuals and 18 entities have already been subject to criminal or civil actions related to SIGTARP investigations, with 17 individuals criminally convicted. SIGTARP's investigative efforts have helped prevent $555.2 million in taxpayer funds from being lost to fraud, and have assisted in the recovery of over $151 million, already assuring that as an agency SIGTARP will more than pay for itself. And with 153 ongoing investigations, including 74 into executives and senior officers at financial institutions that applied for and/or received TARP funding through TARP's Capital Purchase Program ("CPP"), much more remains to be done.

We are approaching the two-and-a-half year anniversary of the enactment of the Emergency Economic Stabilization Act of 2008 ("EESA"), which authorized the creation of TARP. While Treasury's authority to initiate new TARP investments expired on October 3, 2010, signifying an important milestone in TARP's history, this also led to the widespread but mistaken belief that TARP is at or near its end. Approximately $150 billion in TARP funds are still outstanding, and although no new TARP obligations can be made, close to $60 billion already obligated to existing programs may still be expended. While it is therefore premature to deliver a comprehensive evaluation of TARP, the approach of this anniversary makes this a fitting time for an interim assessment. Now in its third year of operation, TARP remains a study in contrasts.

In terms of direct financial costs, TARP's outlook continues to improve. While Congress originally authorized $700 billion for the program, as a result of subsequent Congressional action, Treasury will spend no more than $475 billion. Of the approximately $411 billion disbursed as of the end of last week, Treasury has received back a total of approximately $250 billion in repayments, not including interest, dividends, or sale of warrants. The most recent estimate from the Office of Management and Budget ("OMB") is that the total financial cost of TARP will be approximately $48 billion (assuming all housing

funds are spent), compared to its August 2009 estimate of $341 billion, while the most recent estimate from the Congressional Budget Office ("CBO") contains the more optimistic projection of $25 billion. Just last week, taxpayers received $9.6 billion in TARP repayments. And while recent events such as American International Group, Inc.'s ("AIG") recapitalization plan and General Motors Company's recent initial public offering are also cause for continued optimism, it is also important to remember that Treasury's ultimate return on its TARP investments depends on a host of variables that are largely unknowable at this time. Just recently, for example, the pace at which taxpayer funds will be repaid by AIG was unexpectedly slowed after Treasury waived repayment of $2 billion of net cash proceeds from the sale of AIG's two Japanese-based life insurance subsidiaries so that AIG could shore up the capital of one of its wholly owned subsidiaries, which took an unexpected charge of more than $4 billion to its reserves. Nonetheless, TARP's financial prospects are without question far better today than anyone could have dared to hope just two years ago. One reason for this is the vigorous oversight by the entities represented on this panel today, as well as Treasury's implementation of numerous recommendations from SIGTARP and others designed to protect taxpayer dollars from those who would seek to criminally profit from TARP. As a result, it appears that TARP will experience losses from fraud at a substantially lesser rate than what is typically expected for comparable Government programs.

While the financial costs of TARP may be dramatically lower than earlier anticipated, costs can involve far more than just dollars and cents. Treasury's far too common tunnel-vision focus on the good financial news should not distract from the hard work still ahead, or from the careful and necessary assessment of TARP's considerable, non-financial costs that, while more difficult to measure, may be even more significant. Those costs include the increased moral hazard and potentially disastrous consequences associated with the continued existence of financial institutions that are "too big to fail," the damage to Government credibility that has plagued the program from its inception, and TARP's failure to meet certain goals targeted to help Main Street as well as Wall Street.

In January, SIGTARP published the audit report "Extraordinary Financial Assistance Provided to Citigroup, Inc.," which details how the Government assured the world that it would use TARP to prevent the failure of any major domestic financial institution. Indeed, public statements by then-Secretary of the Treasury Henry Paulson in late 2008 and Treasury Secretary Timothy Geithner in early 2009 made clear that they were ready, willing, and able to use TARP funds to ensure that none of the nation's largest banks would be permitted to fail, and then stood behind Citigroup Inc. ("Citigroup"), along with others such as AIG and Bank of America Corp. While these actions and statements succeeded in reassuring troubled markets, they also did much more. By effectively guaranteeing these institutions against failure, they encouraged future high-risk behavior by insulating the risk-takers who had profited so greatly in the

run-up to the crisis (and indeed, in many cases, since then), from the consequences of failure, and gave an unwarranted competitive advantage, in the form of enhanced credit ratings and access to cheaper credit and capital, to institutions perceived by the market as having an implicit Government guarantee.

Financial institutions now operate in an environment where size matters because the Government guarantee that naturally flowed from the mid-crisis statements by Secretaries Paulson and Geithner that they will not be allowed to fail grossly distorts normally functioning markets, in which an institution's creditors, shareholders, and executives bear the brunt of poor decisions, not the taxpayers. For executives at such institutions, the Government safety net provides the motivation to take greater risks than they otherwise would in search of ever-greater profits. Ratings agencies continue to give such "too big to fail" institutions higher credit ratings based on the existence of an implicit Government backstop. Creditors, in turn, give those institutions access to debt at a price that does not fully account for the risks created by their behavior. Cheaper credit is effectively a Government-granted subsidy, which translates into greater profits, and which allows the largest institutions to become even larger relative to the economy while materially disadvantaging smaller banks. The prospect of a Government bailout also reduces market discipline, giving creditors, investors, and counterparties less incentive to monitor vigilantly those institutions that they perceive will not be allowed to fail. Unfortunately, TARP's most significant legacy may be the exacerbation of the problems posed by "too big to fail." The biggest banks are now larger than ever, fueled by Government support and taxpayer-assisted mergers and acquisitions. According to Kansas City Federal Reserve Bank President Thomas Hoenig, "after this round of bailouts, the five largest financial institutions are 20 percent larger than they were before the crisis. They control $8.6 trillion in financial assets – the equivalent of nearly 60 percent of gross domestic product."

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act"), signed into law by President Obama last July, was intended, in part, "to end 'too big to fail'" and "to protect the American taxpayer by ending bailouts." Secretary Geithner, testifying before the Congressional Oversight Panel ("COP") in June 2010, shortly before the Act's passage, proclaimed that "The reforms will end 'too big to fail.'" The Act's proponents cite several provisions as particularly important components of this effort. These include creation of the Financial Stability Oversight Council ("FSOC"), charged with, among other things, the responsibility for developing the specific criteria and analytic framework for assessing systemic significance; granting the Federal Reserve new power to supervise institutions that FSOC deems systemically significant; granting the Federal Deposit Insurance Corporation ("FDIC") new resolution authority for financial companies deemed systemically significant; requiring the development of "living wills" designed to assist in the orderly liquidation of such

companies; and granting regulatory authority to set more stringent capital, liquidity, and leverage requirements and to limit certain activities that might increase systemic risk.

Whether these provisions will ultimately be successful remains to be seen. They rely heavily on many of the very same financial regulators whose "widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets," according to the Financial Crisis Inquiry Commission ("FCIC"). Many commentators, from Government officials to finance academics to legislators, have expressed concern that the Act does not solve the problem. Kansas City Federal Reserve Bank President Thomas Hoenig remains unconvinced "that our too-big-to-fail problem has been solved," noting just last month that "[m]arket participants and large financial institutions have little reason to doubt that they will be bailed out again" and that "the existence of too big to fail financial institutions poses the greatest risk to the U.S. economy." Massachusetts Institute of Technology professor Simon Johnson agrees, stating in September 2010 that "there is nothing [in the Act] that ensures our biggest banks will be safe enough or small enough or simple enough so that in the future they cannot demand bailout — the bailout potential exists as long as the government reasonably fears global financial panic if such banks are allowed to default on their debts." In his recent testimony before COP, Nobel laureate and Columbia University Professor Joseph E. Stiglitz stated that "too-big-to-fail institutions, whether they be mortgage companies, insurance houses or commercial investment banks, pose an ongoing risk to our economy and the solidness of government finances," and emphasized that the Act's "[r]esolution authority has made little difference, because few believe that the government will ever use the authority at its disposal with these too-big-to-fail banks." Professor Stiglitz thus concluded that the Act "did not go far enough; it was riddled with exceptions and exemptions. It did not adequately deal with the too-big-to-fail banks. . . ." Senators Sherrod Brown and Ted Kaufman, now the chairman of COP (and my co-panelist today), have argued that the Dodd-Frank Act could not and did not by itself provide the *global* regulatory framework required to resolve incredibly complex megabanks operating around the world. Professor Johnson recently testified before COP that without a cross-border resolution authority, we "cannot handle in orderly fashion the failure of a bank like Goldman Sachs or JPMorgan Chase or Citigroup, which operate in 50, 100, 120 countries." Other critics of the Dodd-Frank Act, including Congressman Spencer Bachus, Speaker of the House John Boehner, and Senator Mike Crapo of this committee, have expressed concern that the Act's provisions, particularly those relating to designation and resolution, will not only fail to solve "too big to fail" but actually make it worse by "institutionalizing" Government bailouts.

As even its proponents now concede, the new authorities in the Dodd-Frank Act are a work in progress — a tremendous amount of research and rule making by FSOC, FDIC, and a host of other regulators remains to be done. Their tasks will not be easy. Secretary Geithner told SIGTARP in December 2010, for

example, that identifying non-bank financial institutions as systemically significant, one of the Act's premier mandates, "depends too much on the state of the world at the time." If the Secretary is correct, and regulators have difficulty properly identifying non-banks as systemically significant and therefore subject to the Dodd-Frank Act's restrictions, then the Act's effectiveness will undoubtedly be undermined.

The path regulators choose to take could make all the difference. FDIC Chairman Sheila Bair, for example, has argued repeatedly that regulators should use the Dodd-Frank Act's "living will" provisions as a tool to force companies to simplify their operations and shrink their size if necessary to ensure that orderly liquidation is possible, emphasizing that "[i]f [large financial institutions] can't show they can be resolved in a bankruptcy like process … then they should be downsized now," and that "[i]f we fail to follow through, and don't ensure that these institutions can be unwound in an orderly fashion during a crisis, we will have fallen short of our goal of ending 'too big to fail.'" If Chairman Bair prevails in ensuring that the Dodd-Frank Act is used to simplify and shrink large institutions as necessary, or if some other effective regime is adopted along with similar provisions being implemented internationally, then perhaps in the long run the Dodd-Frank Act will have a chance to end "too big to fail." But as Secretary Geithner acknowledged to SIGTARP in December 2010, "In the future we may have to do exceptional things again if we face a shock that large," even though "[w]e have better tools now thanks to Dodd-Frank. But you have to know the nature of the shock."[1]

Regardless of whether all the required regulations are properly calibrated and fully implemented, the ultimate success of the Dodd-Frank Act depends to a certain degree on market perception. Thus far, the Act has clearly not solved the perception problem. Reflecting Secretary Geithner's candid assessment of the likely limits of Dodd-Frank in the event of a full blown financial crisis, the largest institutions continue to enjoy access to cheaper credit based on the existence of the implicit Government guarantee against failure. Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"), two of the world's most influential credit rating agencies, recently reinforced this significant advantage for those institutions. In January of this year, S&P announced its intention to make permanent the prospect of Government support as a factor in determining a bank's credit rating, a radical change from pre-TARP practice, stating its expectation that "this pattern of banking sector boom and bust and government

[1] It was apparent to SIGTARP from the context of the interview, including the reference to doing something exceptional "again" in the face of a future financial crisis, that Secretary Geithner was referring to the possibility of future bailouts. While Treasury has not disputed the quotation attributed to Secretary Geithner or the context in which it was presented in SIGTARP's audit report, "Extraordinary Financial Assistance to Citigroup, Inc.," at least one Treasury official has suggested that Secretary Geithner was actually referring to using the tools of the Dodd-Frank Act.

support to repeat itself in some fashion, regardless of governments' recent and emerging policy response." Similarly, also in January, Moody's stated its belief that the proposed resolution regime "will not work as planned, posing a contagion risk and most likely forcing the government to provide support in order to avoid a systemic crisis." Because of this belief, Moody's intends to continue assuming government support for the eight largest banking organizations. In short, S&P and Moody's are telling the market that they do not believe that the Dodd-Frank Act has yet ended the problems of "too big to fail," and given the discounts that such institutions continue to receive, the market seems to be listening. In fact, some recent reports suggest that the largest banks' funding advantage over their smaller competitors has actually *increased* since the passage of the Dodd-Frank Act. As former Treasury Secretary and National Economic Council Director Lawrence Summers said more than a decade ago, "a healthy financial system cannot be built on the expectation of bailouts." Unless and until institutions viewed by the market as "too big to fail" are either broken up, so that they are no longer a threat to the financial system, or a structure is put in place to assure the market that they will be left to suffer the full consequences of their folly, the prospect of more bailouts will potentially fuel more bad behavior with potentially disastrous results. In this sense, TARP's price tag goes far beyond dollars and cents, and its ultimate cost will remain unknown until the next financial crisis occurs.

Another fundamental non-financial cost of TARP is the potential harm to the Government's credibility and the public's eroding trust in Government that has attended this program. Despite the recent surge in reporting on TARP's successes, many Americans continue to view TARP with anger, cynicism, and mistrust. While some of that hostility may be misplaced, much of it is based on entirely legitimate concerns about the lack of transparency, program mismanagement, and flawed decision-making processes that continue to plague the program. When Treasury refused for more than a year to require TARP recipients to account for the use of TARP funds, or claimed that Capital Purchase Program participants were "healthy, viable" institutions knowing full well that some were not, it damaged the public's trust to a degree that is difficult to repair. When Treasury revised its AIG loss estimate in October 2010 without disclosing that the new lower estimate followed a change in the methodology Treasury previously used to calculate losses on its investment, and that it would be required by its auditors to use the older, less favorable, methodology in the official audited financial statements in mid-November 2010, it left itself vulnerable to charges that it placed short-term political concerns ahead of transparency in its communications with the American people. Similarly, when the Government failed to negotiate robustly on behalf of the taxpayer, as it did when agreeing to compensate AIG's counterparties 100 cents on the dollar for securities worth less than half that amount, or when Treasury made critical and far-reaching decisions without taking an even modestly broad view of their impact, such as pushing for dramatically accelerated automobile dealership closings without considering the potential for devastating job losses, or

when it promotes programs without meaningful goals or metrics for success, such as its mortgage modification programs, the public's negative perception of TARP should hardly come as a surprise.

According to recent testimony from a Treasury official, Treasury acknowledges that it "certainly could have done a better job explaining what [it was] doing" and "why [it was] doing it." Transparency, of course, should not be a program afterthought, and TARP's problems, which are ongoing, run much deeper than mere failures of explanation. When we face the next financial crisis, public confidence will be essential to buttress the political will necessary to undertake the difficult and expensive steps that may be needed. Unfortunately, the avoidable damage to Government credibility occasioned by the mishandling of TARP has dangerously undermined the Government's ability to respond effectively in the future. In other words, for all its help in rescuing the financial system from the brink of collapse, TARP may have left a truly frightening legacy: It has increased the potential need for future Government bailouts by encouraging the "too big to fail" financial institutions to become even bigger and more interconnected than before, therefore *increasing* their ultimate danger to the financial system, while at the same time, Treasury's mismanagement of TARP and the resulting deep unpopularity of the program have *decreased* the Government's ability to actually accomplish such bailouts in the future, even if necessary.

Part of the potential harm to the Government's credibility that has attended this program relates to TARP's failure to meet several of the most fundamental goals set for it by both Treasury in announcing TARP programs and Congress in providing Treasury authorization to expend TARP funds – in particular, "increas[ing] lending," "provid[ing] public accountability," "preserv[ing] homeownership," and "promot[ing] jobs and economic growth." In Treasury's view, although EESA included these goals, the authorities Congress provided Treasury "were narrower than that." According to recent testimony from a Treasury official, Congress directed Treasury specifically to "promote the stability and liquidity of the financial system" through the purchase of troubled assets and in doing so, Treasury was only "supposed to take those other considerations into account," but it was not, for example, given $700 billion and told to "reduce the unemployment rate in any way [it saw] fit." In short, Treasury apparently now contends that the issues surrounding unemployment, foreclosures, and credit provision are not its responsibility under TARP. Treasury's view, however, runs contrary to what many believe TARP was designed to accomplish. For example, during his recent testimony before COP, Professor Stiglitz emphasized that "TARP was justified to the American people as necessary to maintain the flow of credit, the lifeblood of an economy. It was hoped that it would play a pivotal role in dealing with the flood of mortgage foreclosures and the collapse of the real estate market that led to the financial crisis." Treasury's remarkably late complaint about the lack of authority from Congress sounds more like excuse than explanation.

In measuring TARP's success in fulfilling its goals, it is useful to compare its impact on both Wall Street and Main Street. By fulfilling the goal of avoiding a financial collapse, there is no question that the dramatic steps taken by Treasury and other Federal agencies through TARP and related programs were a success for Wall Street. Those actions have helped garner a swift and striking turnaround, accompanied by a return to profitability and seemingly ever-increasing executive bonuses. For large Wall Street banks, credit is cheap and plentiful and the stock market has made a tremendous rebound. And as noted above, the largest of the Wall Street financial institutions continue to reap tangible benefits from Treasury's explicit proclamation in late 2008 and early 2009 that it would not let them fail. Main Street, too, has reaped a significant benefit from the prevention of a complete collapse of the financial industry and domestic automobile manufacturers and the ripple effects such collapses would have caused, as well as from rising stock market prices. Main Street, however, has largely suffered alone with respect to those areas in which TARP has fallen short of its other goals.

As SIGTARP's quarterly reports to Congress have well chronicled, TARP's Main Street goals of "increas[ing] lending" and "promot[ing] jobs and economic growth" have been largely unmet. Indeed, it bears noting, as Joseph Stiglitz did at the most recent COP hearing, that "TARP and the recovery of troubled assets were not ends in themselves, but means to an end, namely the recovery of the economy." After two years of steady decreases in overall lending following the hundreds of billions of TARP dollars provided to banks with the express purpose to increase lending, only now are there signs that lending is beginning to increase. TARP's failure in this regard may in part be due to Treasury's failure to require or incentivize increased lending through TARP's capital infusion programs for financial institutions – the Capital Purchase Program, the Targeted Investment Program, and the Community Development Capital Initiative. In addition, for more than a year, Treasury did not even require TARP recipients to report on how they used TARP funds, providing an opaque cover for those institutions that continued to cut lending, and avoiding accountability for Treasury itself. And while the large banks were rescued, many of the smaller community and regional banks that are responsible for much of the lending to consumers and small businesses are in trouble. According to the FDIC, the number of banks at risk of failing rose for the 17th straight quarter to 884 during the fourth quarter of 2010, which means that one in nine FDIC-insured institutions is at risk of collapse.

TARP's failure to realize EESA's most specific Main Street goal, "preserving homeownership," has had perhaps the most devastating and tragic consequences. To be clear, notwithstanding Treasury's recent claims that Congress did not give it the necessary tools to achieve the Main Street focused goals of EESA, there is little question that the promise of providing foreclosure relief was part and parcel of the prior Administration's ability to secure the passage of EESA in 2008. At the time, it was generally understood

in Congress that Treasury was going to use the $700 billion to purchase mortgage-related assets, such as whole loans and mortgage-backed securities. As Representative Luis Gutierrez recently noted, for many members of Congress, their votes in support of EESA were based on the understanding that after these mortgages were purchased, the goal of "preserving homeownership" would be pursued through Treasury's modification of those mortgages for eventual resale into the market, a sentiment that was marked by Senator Reed of this committee at the time EESA was passed, stating "we cannot simply assist Wall Street," but also "homeowners who are facing foreclosure."

Treasury's decision to abandon its plan to purchase troubled assets did not relieve it of its obligation to fulfill its promise to members of Congress and to the American people that TARP would be used to meet the goal of preserving home ownership. Unfortunately, notwithstanding recent attempts to redefine this obligation, Treasury has come up tragically short. The Home Affordable Modification Program ("HAMP"), the Administration's signature foreclosure prevention program, began with much promise to meet this goal, with initial expectations to "help up to 3 to 4 million at-risk homeowners avoid foreclosure" "by reducing monthly payments to sustainable levels." But as SIGTARP and the other TARP oversight bodies represented at this hearing today – COP and the Government Accountability Office ("GAO") – have detailed in various audits and reports, HAMP has been beset by problems from the outset and, despite frequent retooling, continues to fall woefully short of meeting its original expectations. Today the program is under siege from all quarters, with near universal agreement that the program has failed to meet its goals, and the current debate understandably centering on whether the program should be terminated, replaced or revamped.

The frustration expressed from both sides of the aisle is understandable. The problems that HAMP and its companion programs are meant to address, unfortunately, remain painfully clear as the housing crisis continues to have devastating consequences for millions of families across the nation. As SIGTARP described in its January 2011 Quarterly Report to Congress, the housing market conditions at the end of 2010 were remarkably discouraging. According to RealtyTrac data, a record 2.9 million homes received foreclosure filings in 2010, up from 2.8 million in 2009, and 2.3 million in 2008. Realty Trac had estimated a 20 percent increase in 2011, although that number may be affected by its recent report that foreclosure filings were down last month. It appears, however, that the decrease was driven by allegations of improper foreclosure processing, which have disrupted court dockets and severely restricted the industry's capacity to process foreclosures, rather than an improving housing market. RealtyTrac expects that the number of foreclosure filings will increase again, but that could take several months. Some estimate that as many as 13 million homes will be subject to foreclosure filings during the operative stage of HAMP.

In contrast, only a small fraction of struggling homeowners are the beneficiaries of ongoing permanent mortgage modifications under HAMP. While Treasury's recent press releases indicate that close to 608,000 homeowners have received permanent modifications, that number ignores the approximately 68,000 of these "permanent" modifications that were later cancelled. According to Treasury's January 2011 Making Home Affordable Program report, the number of *ongoing* permanent modifications has now reached just less than 540,000. Less than half of those, almost 246,000, were funded by and attributable to TARP. The remaining modifications were funded outside of TARP by the Government Sponsored Entities ("GSEs"). A combined total of more than 808,000 trial and permanent modifications have been cancelled, with more than 145,000 trial modifications still in limbo. Based upon extensive research conducted by ProPublica, HAMP has not materially altered the average rate of industry-wide modifications over the past two years, which still stands at the pre-HAMP monthly rate, and only about one in five homeowners who applied for a HAMP modification have received a permanent modification.[2] These permanent modification numbers pale in comparison not only to foreclosure filings, but also to Treasury's initial prediction that HAMP would "help up to 3 to 4 million at-risk homeowners" "by reducing monthly payments to sustainable levels." As Senator Whitehouse stated last month, "[t]he HAMP program is operating at one-fifth of its self-defined level of success, which is about less than half of the actual foreclosure liability that we face as a country. So that can't be seen as anything resembling a success."

HAMP's failure to meet its original expectations has many causes, starting with a rushed launch based on deficient analysis, a flawed incentive structure that could not overcome the conflicts of interest inherent in the Treasury-designed program, and insufficiently developed rules requiring frequent changes to program guidelines. The unnecessary confusion and delay that accompanied the hasty rollout were exacerbated by Treasury's initial decision (later corrected) to encourage servicers to accept homeowners into trial modifications without requiring adequate documentation of income, despite SIGTARP's warning of the hazards of doing so. And while Treasury now acknowledges that "when HAMP was launched in early 2009, servicers were totally unequipped to deal with a crisis," Treasury's design of HAMP as a program so entirely dependent on servicer competence, along with its decision to flood those same "unequipped" servicers with trial modifications based on unverified data, in no small part contributed to the well-documented servicer failures that followed.

Any credible assessment of whether HAMP should be permitted to continue must start with Treasury's clear articulation of the number of sustained permanent modification it believes HAMP will deliver.

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[2] Olga Pierce and Paul Kiel, "By the Numbers: A Revealing Look at the Mortgage Mod Meltdown," ProPublica (Mar. 8, 2011) (online at www.propublica.org/article/by-the-numbers-a-revealing-look-at-the-mortgage-mod-meltdown).

Remarkably, despite consistent and repeated recommendations from SIGTARP and the other TARP oversight bodies, as well as members of Congress, Treasury has steadfastly refused to adopt expectations and goals for the most meaningful aspect of HAMP – permanent modifications that offer secure, sustainable relief to the program's intended beneficiaries. Rather than develop such goals and metrics, which would allow more meaningful oversight, promote accountability, and provide guidance for useful change, a Treasury official in recent testimony before the House Financial Services Committee merely promised "to reach out to as many eligible homeowners as possible to our program's expiration in 2012."

In December 2010, COP attempted to fill the void left by Treasury by estimating that, if current trends hold, HAMP will result in only 700,000 to 800,000 effective permanent modifications. Since then, other entities have formulated their own estimates, with Mark Zandi, chief economist of Moody's Analytics, recently predicting that HAMP will result in approximately 750,000 effective permanent modifications, while just last week, CBO estimated that if the HAMP Termination Act of 2011 (H.R. 839) were to be enacted by June 2011, it would prevent a total of 100,000 new modifications of non-GSE mortgages in the eighteen months spanning between June 2011 and December 2012. Unfortunately, these bleak projections appear all too reasonable, with participation trends getting worse each quarter.

Rather than confirm or reject COP's estimate, or provide one of its own, Treasury does something astonishing: albeit in the context of calculating HAMP's total cost, it suggests both that COP's estimate might be accurate, which would mean roughly an additional 160,000 to 260,000 ongoing permanent modifications by program's end, or that the total might be *twice* COP's estimate, which would mean roughly an additional 850,000 to 1,050,000 ongoing permanent modifications by program's end. Treasury's suggestion that the number of new ongoing permanent modifications might vary by a factor of close to 10 can hardly give comfort to those interested in saving HAMP. Nor does it provide the American people and their representatives in Congress with the kind of information that is absolutely necessary in evaluating whether the program should be shut down, significantly revamped, or permitted to stay on its current course.

The foundation for Treasury's claim that HAMP should be permitted to continue in its current form appears to be that while HAMP is not designed to help every homeowner at risk of foreclosure, at least the program is helping *some* families, even if it is nowhere near the number originally promised. Treasury continues to rely on trial modifications as a measure of success – just last month it highlighted the "temporary relief" such modifications provide, reinforcing its prior declaration that "every person who is in a temporary modification is getting a significant benefit." Treasury has also regularly changed its

criteria for success, citing at different times the total number of trial modification offers extended to borrowers, regardless of whether they were accepted, and then the total number of trial modifications, regardless of whether they became permanent, which far fewer than half have actually done. While the close to 540,000 families that benefit from ongoing permanent HAMP modifications have certainly met with success, this does not make the program itself successful. A more meaningful measure is the potentially millions of homeowners who the program expected to help, but may never be provided with meaningful assistance because of flaws in the program's design, management and execution. And while Treasury's descriptions of the individuals and families helped by HAMP, now featured prominently in Treasury's daily blog postings, are no doubt powerful testaments to HAMP's potential to help individual struggling homeowners remain in their homes and avoid foreclosure, they only highlight the lost opportunity to help so many more. At the same time, they also ignore, and arguably disserve, the individuals and families who have suffered real and demonstrable harm from failed trial modifications under HAMP. In SIGTARP's October 2010 Quarterly Report, SIGTARP provided examples of the damage that failed trial modifications have inflicted, including complaints received through SIGTARP's hotline. Since then, there have been countless published reports of HAMP participants who end up far worse off for having engaged in a futile attempt to obtain the sustainable relief that the program promised. Failed trial modifications often leave borrowers with more principal outstanding on their loans, less home equity, depleted savings, and worse credit scores. And even in situations where those homeowners never missed a payment, servicers are permitted, with Treasury's explicit approval, to impose on them back payments, penalties, and even late fees that become due once their trial modification is cancelled. The impact of these added burdens becomes even greater when trial modifications are allowed to continue long past the three-month period called for by the program.

To be sure, if HAMP continues in the status quo, some incremental number of families will certainly benefit from new, ongoing permanent modifications.[3] But without any estimate from Treasury about what that incremental number will be, it is nearly impossible to measure the incremental benefit against the additional costs of continuing at the current pace, including the additional administrative costs, the opportunity costs of not pursuing potentially more effective alternatives, the harm inflicted on those who will inevitably enter into modifications that later fail, and further harm to Government credibility.

[3]Although Treasury argues that the proposed termination of HAMP would prevent up to 30,000 homeowners a month from receiving a permanent modification, the estimates provided by COP, Moody's Analytics, and CBO all suggest that HAMP will generate results lower than an additional 30,000 permanent modifications per month. Moreover, it is important to note that the majority of HAMP modifications are done by the GSEs, without the benefit of TARP funds. Indeed, Treasury reported that in January of this year there were only 13,555 new TARP funded permanent modifications, which were offset by 5,373 cancellations.

One additional defense Treasury offers against terminating HAMP is its claim that the servicing industry "was not and still is not fully equipped to deal with this crisis. Ending HAMP now will mean that the fate of struggling homeowners will be solely up to the servicers." While Treasury's acknowledgement of the abysmal performance of servicers is important, its use of that observation to justify the continuation of HAMP has a through the looking glass quality to it. By its very design, HAMP puts the "fate of struggling homeowners" squarely in the hands of servicers. Under HAMP, servicers not only operate as the point of contact for distressed homeowners seeking to participate in the program but also administer the loans on behalf of investors. In short, Treasury has already placed virtually all of HAMP's eggs in the servicer basket. Further, Treasury's implicit suggestion that it can and will control servicer behavior within HAMP is utterly belied by experience, and more recently, by its own admission of impotence in the face of servicer misconduct in HAMP. Despite nearly daily accounts of servicer errors and more serious misconduct, Treasury reported to SIGTARP that as of December 31, 2010, it had yet to impose a financial penalty on, or withhold or claw back incentives from, a single servicer for any reason other than failure to provide data. ProPublica's analysis of Treasury data over the past year indicates that borrower complaints about servicers are increasing, despite Treasury's claims that servicers have improved. Any hope for meaningful changes to servicer practices, it seems, will have to come from outside of HAMP.

In recent months, Treasury's evolving defense of HAMP has also featured the claim that HAMP has had a beneficial impact on private modifications that occur outside of the HAMP program. This too is a questionable measure of success. While Treasury may deserve credit for having had a positive, if inadvertent, impact on industry practice, according to a December 2010 COP report, "when pressed, Treasury acknowledges that there is no clear causal link between HAMP and proprietary modifications." Furthermore, while data suggests that proprietary modifications have generally improved from the homeowner's perspective since the launch of HAMP, the terms of such modifications are typically far less advantageous, often including more unfavorable terms for the borrower, higher rates of redefault, and broader imposition of servicer fees that are specifically prohibited in HAMP. This view was made clear in recent testimony from a HUD official, who stated that "the HAMP program clearly is more effective" and advantageous for homeowners than any proprietary modification programs, which he confirmed have lower reductions in monthly payments and higher redefault rates. In other words, it is odd for Treasury to celebrate modifications whose terms would largely be unacceptable from both the borrower's and Treasury's perspective in HAMP. In addition, ProPublica's research indicates that mortgage servicers, in a return to pre-HAMP practices, have increasingly been putting struggling homeowners into repayment plans instead of modifications, which are a more onerous option for those borrowers because they increase monthly payments. Furthermore, touting such proprietary modifications as a HAMP "success" also undermines Treasury's defense of the need to continue HAMP. If it truly views these modifications

in such an admiring light, it raises the very serious question as to why taxpayers should continue to fund HAMP.

Secretary Geithner has at least begun to acknowledge the program's obvious shortcomings, recently conceding that HAMP "won't come close" to the initial estimate of helping 3 to 4 million at-risk homeowners avoid foreclosure. Secretary Geithner has also finally acknowledged what SIGTARP and the other oversight entities have been stating for some time, that loan servicers – which by design bear the central responsibility for implementing HAMP – "are still doing a terribly inadequate job." Further, the Secretary admitted that the program suffers from a design flaw that goes to its very heart, with the recognition that the incentives to servicers that were intended to serve as the engine of HAMP simply "have not been powerful enough" within the program as designed by Treasury. While these admissions about the fundamental flaws in HAMP represent a step forward, they come very late in the game and unaccompanied by any consequential changes to the program or meaningful statement of program goals. Indeed, notwithstanding Secretary Geithner's recent statements, those responsible for administering HAMP continue to celebrate the status quo, expressing no intent to meaningfully respond to these failures in performance or design, choosing instead both to accept and to tout HAMP's dismal results. In late February, a Treasury official reportedly declared to applauding servicers at a Mortgage Bankers Association conference that the attendees would not "see any major new programs coming out," and that while Treasury "may tweak around the edges," its "primary objective in 2011 is excellence in the program we have."[4] In blog postings, Treasury officials have actually been touting HAMP's abysmal numbers as a *defense* to those calling for its termination. In short, Treasury stands alone in defending the status quo, with those opposed to terminating HAMP calling on the Administration to make deep and necessary changes.

As a result of HAMP's failures, considerable TARP funds that could have been made available through better program design and administration may well never reach the distressed homeowners on Main Street whom Congress intended to benefit from TARP just as much as the rebounding Wall Street financial institutions. As a result, we have little reason to hope that a program that began with much promise will be anything more than it is today – a program that assists only the small portion of distressed homeowners who benefit from a sustainable permanent modification, offers others little more than false hope, and in certain cases causes more harm than good.

[4] Jon Prior, *Treasury makes adjustments to give HAMP a chance*, HousingWire (Feb. 24, 2011) (online at www.housingwire.com/2011/02/24/treasury-makes-adjustments-to-give-hamp-a-chance).

While TARP is undoubtedly winding down, it is far from over. With the sunsetting of the Congressional Oversight Panel and the excellent work it has done, the remaining oversight bodies will need to redouble their efforts. For SIGTARP, in addition to our continued commitment to program transparency and accountability through our reporting and auditing functions, the work will also increasingly focus on criminal and civil investigations into the conduct of those who have stolen or attempted to steal from the taxpayers' investment in TARP, as well as those who would fraudulently exploit the existence of TARP programs for their own gain.

Finally, on a personal note, today likely represents my last time testifying before the United States Senate before I step down at the end of the month to join New York University's School of Law as an adjunct professor and senior fellow for its Center on the Administration of Criminal Justice and the Mitchell Jacobson Leadership Program on Law and Business. In the nearly two-and-a-half years since I first appeared before this Committee at my confirmation hearing, I have been blessed with the opportunity to serve our country as it has struggled through this financial crisis, and I would like to thank the members of this Committee for their unwavering and bipartisan support of our office. Without that support, it is unlikely that SIGTARP would have ever been able to achieve our goals of bringing transparency to TARP, holding its participants accountable, and deterring and prosecuting those who have sought to take criminal advantage of this national crisis.

Chairman Johnson, Ranking Member Shelby, and members of the Committee, thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the troubled asset relief program, please contact the SIGTARP Hotline.

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